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The Russian and Eurasian Energy Outlook and US National Interests

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Europe and Eurasia Subcommittee, House
International Relations Committee**

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My name is Ariel Cohen. I am Senior Research Fellow for Russian and Eurasian Studies and International Energy Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

As a giant energy producer and major energy transit country, Russia is an important player in the field of global energy production. Russia has the largest reserves of natural gas in the world, and possesses some 79.4 billion barrels of oil, approximately 6.4% of the world's total.¹ In 2009 oil production, Russia accounted for 9.9 million barrels per day (mbd), competing only with Saudi Arabia for the title of number one oil producer.² Total Russian net oil exports reached 7 mbd the same year.³ Russia produced 527.5 billion cubic meters of natural gas during the recession in 2009, second only to the United States.⁴ In addition, large areas of Eastern Siberia and the Arctic are still unexplored and, according to experts, are expected to yield up to a quarter of the world's energy supply.

Despite its vast resource base and its formal assurances of its reliability as a partner, Moscow has already proved that it is willing to hike up oil and gas prices to match the general trend of higher energy prices, engage in anti-free market practices, especially at home and in Europe, and use energy as a foreign policy tool.

Russia is willing to use force to achieve its geo-economic goals as well. Control of energy corridors from the Caspian Sea to the Black Sea and beyond was an objective of the Russian military operation against Georgia in August 2008. This has been clearly confirmed by other incidents involving delays in energy supplies to Ukraine, Azerbaijan, Belarus, Georgia and the Baltic states. Many argue that Moscow's international energy behavior leaves its partners insecure and makes observers doubt that Russia is a responsible player, especially when unconstrained by competition and powerful investment sources.

To this day, Moscow is dependent upon the massive pipelines built during the Soviet era. Russia's energy policy is facilitated by the Soviet-era oil and gas infrastructure that ties Central Asian producers to Russia for their access to external markets. As part of its strategy, Russia

¹ BP 2007 Energy Survey, June 2008, p. 6,
http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/downloads/pdf/statistical_review_of_world_energy_full_review_2008.pdf

² EIA, *Russia Gas*, Country Analysis Briefs, Department of Energy, Energy Information Agency, November 2010,
http://www.eia.doe.gov/emeu/cabs/Russia/Oil_exports.html (Accessed February 28, 2011)

³ *Ibid.*

⁴ BP 2009 Energy Survey, June 2010, p. 22,
http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/2010_downloads/statistical_review_of_world_energy_full_report_2010.pdf

works to maintain control over energy transportation routes and opposes any projects that could provide Europe with alternative supply lines. European demand was very high before the recent economic crisis, and is projected to grow further provided the current geopolitical instability does not cause another global recession. Eastern Europe consumes even higher percentages of Russian energy, with several countries entirely dependent on Russian gas. However, US and Europe should have serious reservations concerning Russian practices that limit access to the market, tend to promote corruption, and expand Moscow's energy transport agenda.

Russian Energy Policy Overview: Energy Nationalism and Abuse of State Ownership

Russia has criticized Europe's approach to international energy security as limited to the interests of energy importers. Under Russia's presidency in the Group of Eight (G8), then-President Vladimir Putin made energy relations a central theme at the 2006 summit in St. Petersburg, presenting his own vision for "global energy security".⁵ While talking of interdependence and dialogue, Russia insisted on demand guarantees for the producers, and sharing responsibilities and risks among energy suppliers, consumers, and transit states. Putin spoke of joint commitments to work on the energy arena with coordination and distribution of profits and risks to prevent energy conflicts.⁶ This would not be a problem if Russia allowed international oil companies (IOCs) minimally restricted access to its energy resources. Unfortunately, since 2003 this hardly has been the case, as the state has pursued a policy of monopolizing gas production and oil and gas pipeline transportation, and has tightened its grip on the quickly growing oil production sector by effectively expropriating YUKOS and buying the Sibneft and Russneft oil companies.

The trend toward marginalizing and even actively persecuting independent Russian energy businesses has continued, with the controversial re-sentencing of Russian oil magnate Mikhail Khodorkovsky in December of 2010, resulting in six more years in prison for the former businessman.⁷ His appeal to the Moscow City Court was rejected on May 24th, 2011, despite the fact that President Medvedev publicly announced that Khodorkovsky does not represent a danger to public order. Moreover, after a seven-year delay, Amnesty International finally declared Khodorovsky a prisoner of conscience.⁸

The Khodorkovsky case is particularly symbolic. In 2003, the former oil tycoon went from being one of Russia's leading energy capitalists, owner of the YUKOS Oil Company and a promoter of economic and political liberalization, to a political prisoner. Of course, YUKOS was subsumed into Igor Sechin's Rosneft, a major state-owned oil company until recently. Before he was imprisoned, Khodorkovsky's opposition to then-President Vladimir Putin's authoritarian administration and the spread of corruption resulted in a long list of absurd charges

⁵ Nina Kulikova, "Voprosy Energeticheskoy bezopasnosti – pozitsiya Rossii [The Issues of Energy Security – Russia's Position]," *RIA Novosti*, September 1, 2006, <http://www.rian.ru/analytics/20060901/53406077.html>

⁶ *Global Energy Security Fact Sheet*; Official Website of G8 Summit in St. Petersburg, 2006, http://www.en.g8russia.ru/press/facts/global_energy/ (Accessed March 5, 2011)

⁷ Vasilyeva, Nataliya, Russian Tycoon Khodorkovsky gets 6 more years, *Washington Times*, World News section, December 30, 2010, <http://www.washingtontimes.com/news/2010/dec/30/russian-tycoon-khodorkovsky-gets-6-more-years/> (Accessed March 1, 2011)

⁸ "Amnesty International declares Khodorkovsky 'prisoner of conscience'", *RIA Novosti*, <http://en.rian.ru/russia/20110524/164210044.html> (May 28, 2011)

of tax evasion and fraud. Somehow, even the fact that YUKOS was making a profit under his leadership became a chargeable offense.

The last conviction was handed down on December 29, 2010, after Khodorkovsky was accused of stealing 350 million tons of oil from his own company, a claim made all the more unbelievable given that the Russia state accounted for – and taxed – all the oil YUKOS sold, and that the total alleged production figures were higher than YUKOS' reported output.⁹

The tainted nature of this case became even more evident after lawyer and blogger Alexei Navalny's exposé of corruption in the construction of Transneft's massive East Siberian pipeline. Some four billion U.S. dollars have been stolen or defrauded by individuals close to the Kremlin with no redress.¹⁰ Instead of thanking the whistle blower, the authorities paid Navalny back by launching a criminal investigation against him.

The non-transparent, unfair nature of the Khodorkovsky cases has received a great deal of criticism from Western leadership, including a statement from President Obama as well as European governments.¹¹ The matter highlights not only the "vendetta" politics of contemporary Russia,¹² but also that fact that the Russian government, not energy companies or international markets, sets policy on the nation's economy, and particularly its energy sector.

Energy Superpower?

Russia's Energy Strategy, adopted in 2003, sets the framework for the country's energy policy. Thus, Russian energy security builds upon "protection of the country, its citizens, and economy from [external and domestic] threats to the reliable energy supply," including geopolitical and energy market risk factors.¹³ Moscow claims to promote a non-discriminative regime for the Russian companies to access foreign energy markets and advance their participation in large international oil and gas projects. Energy factors are placed in the center of Russian diplomacy. As then-President Putin noted in one of his speeches, "the place Russia takes in global energy cooperation directly impacts its current and future wellbeing."¹⁴ Russia's energy strategy through 2030, formulated in 2009, predicted even greater increases in Russia's oil and gas production sector, despite issues with property rights, an impractical and unevenly enforced tax code, the huge scope of needed investments, and concerns about the obsolescent infrastructure.¹⁵ With ample energy resources and a dominant position in the European market, Russia's hydrocarbon power will remain impressive into 2020 and beyond. Russia's decision

⁹ Simon Shuster; Khodorkovsky Case: Russia's Courtroom of the Absurd; *Time*, Dec. 27, 2010, <http://www.time.com/time/world/article/0,8599,2039824,00.html>

¹⁰ Volchok, Dmitry; Юрист Алексей Навальный – о коррупции в компании "Транснефть" [Jurist Aleksei Navalny – on corruption in Transneft]; *Радио Свобода* [Radio Liberty, Russian language], November 20, 2010, <http://www.svobodanews.ru/content/article/2225552.html>

¹¹ Ariel Cohen; "Free Khodorkovsky"; *Heritage Commentary*, March 10, 2010, <http://www.heritage.org/research/commentary/2010/03/free-khodorkovsky>

¹² Tisdall, Simon. "Mikhail Khodorkovsky: The latest victim of Vladimir Putin's vendetta politics"; *The Guardian*, December 27, 2010, <http://www.guardian.co.uk/world/2010/dec/27/mikhail-khodorkovsky-vladimir-putin>

¹³ "Energy Strategy of the Russian Federation for the Period till 2020," <http://www.minprom.gov.ru/docs/strateg/1>.

¹⁴ V. Salgin, "Globalnaya energeticheskaya bezopasnost' I vneshnyaya energeticheskaya politika Rossii [Global Energy Security and Russia's Foreign Energy Policy]," *Neftegaz*, June 28, 2007, <http://www.neftegaz.ru/analit/reviews.php?id=548>

¹⁵ Blagov, Sergei, Reality Check for Russian Oil, *Asia Times Online*, Central Asia section, January 5, 2011, http://www.atimes.com/atimes/Central_Asia/MA05Ag01.html (Accessed March 1, 2011)

makers sense that consumer governments and companies, anxious to gain access to coveted barrels and cubic meters, do not want to challenge the supplier's assertive foreign policy.

In the remaining years until 2020, Russia seeks to maximize its economic and geostrategic advantages as a major energy producer with vast hydrocarbon reserves. This becomes even more poignant as Middle East supplies are now suffering from the repercussions of the "Arab spring" and the future of the nuclear power has become more uncertain as a result of the nuclear power station disaster triggered by the recent tsunami that struck Japan.

The Kremlin has advanced Russia's energy strategy through an array of security and economic policies, all of which aim at a common strategic goal. The aggregate effect is to create customer country dependency by locking in demand with energy importers and consolidating oil and gas supplies by signing long-term contracts with Russian and Central Asian state-owned or state-controlled energy producers and Russian state-owned pipeline monopolists.

Europe is mainly concerned about potential supply disruptions resulting from government actions or policies that impact gas supply sources and transit. In recent years, the issue of gas corridor diversification has become increasingly important for Europe as EU officials try to reduce the region's dependence on Russian gas.

Arctic Energy Strategy

When the Russian flag was planted on the Arctic seabed under the North Pole in 2007, this was no pretense at subtlety. The act was overt and audacious. Moscow claims a sector of the energy-rich Arctic continental shelf along the Lomonosov Ridge, an underwater structure protruding from the northern coast of Eurasia towards the North Pole and abutting the Canadian and Danish sectors. Vladimir Putin weighed in during a speech on a Russian nuclear-powered icebreaker in early 2007, urging greater efforts to secure Russia's "strategic, economic, scientific and defense interests" in the Arctic.¹⁶ Moscow's moves are dictated by energy-driven geopolitics and geo-economics. Geologists believe the Arctic Ocean's seabed may contain nearly 25 percent of the world's remaining hydrocarbon deposits. It is also rich in diamonds, and precious ferrous and non-ferrous metals.¹⁷ As the ice cap melts and shrinks, these resources will become more accessible and a new sea passage along the northern coast of Eurasia may provide a cheaper transportation route.

From a geopolitical perspective, the exploration of polar petroleum reserves may be the kind of opportunity that allows Russia to become what then-President Putin termed "an energy superpower." Russia seeks to expand its continental shelf beyond the 200-mile economic zone through a mechanism provided by the UN Commission on the Limits of the Continental Shelf under the 1982 U.N. Law of the Sea Convention (UNCLOS), to which Russia is a party. Moscow claims that two underwater mountain ridges jutting into the Arctic Ocean from the Russian continental shelf—the Lomonosov Ridge and the Mendeleev Ridge—are extensions of

¹⁶ Ariel Cohen, "Russia's Race for the Arctic," Heritage Foundation *WebMemo* No. 1582, August 6, 2007, http://www.heritage.org/Research/RussiaandEurasia/upload/wm_1582.pdf

¹⁷ Alexander Gabuev, "Print – Cold War Goes North: Russia and the West begin the race for the Arctic Region," *Kommersant*, August 4, 2007

the Eurasian landmass¹⁸. The span of this area of seabed approximates the size of France, Germany and Italy combined. Russia's first claim with the UN, submitted in 2001, failed due to insufficient evidence.

In recent years, Russia has aggressively moved forward with the expansion its presence in the Arctic region, while the US has been less active in advancing its interests in this strategically important region endowed with vast natural resources.¹⁹ As Arctic sea-lanes are becoming more navigable due to climate change, the competition for the vast natural resources of the Arctic is more likely to intensify. In February 2011, Russia's state-controlled Rosneft and British petroleum giant BP entered into an agreement to develop Arctic oil fields with estimated reserves of 5 billion tons of oil and 10 trillion cubic meters of gas. However, Russian Arctic energy development is likely to face difficulties because of the significant risks and costs associated with Arctic offshore drilling.

Great challenges also abound for the Arctic and East Siberian/Far East gas fields. These reserves lack functioning gas fields and pipelines, and require hundreds of billions of dollars in investments. Many hopes were hung on the Shtokman gas field, located over 300 miles offshore in the Barents Sea, where local sea depths exceeding 300 meters.²⁰ After many delays, Gazprom reconsidered its earlier decision to develop the field alone. In July 2007, Gazprom signed an agreement with France's Total, followed by a deal with Norway's Statoil Hydro in October 2007 covering the first phase of Shtokman development.²¹ U.S. companies were kept out despite earlier promises to include Chevron and possibly Conoco Phillips. However, the agreement gives Total and Statoil Hydro no ownership rights to the gas. Gazprom, through its 100 percent-owned subsidiary Sevmorneftegaz, remains the full owner of the Shtokman development license and will be the full owner and sole exporter of products.²²

While Norway's Statoil Hydro has vast experience drilling off shore in the northern longitude, Total is cash-rich but has no experience working in Arctic conditions.²³ The completion of the Shtokman field in the Arctic has now been pushed back to 2016. Other fields under development in the Arctic and polar regions are often even more challenging than Shtokman. Only in the case of the Kovykta field in East Siberia is production assured: this field was essentially expropriated away from BP by the GOR and handed over to Gazprom, which the GOR controls, so that Gazprom could develop it and build a pipeline to China. Likewise, there is substantial additional gas in Eastern Siberia, including in Yakutia, which could be developed for the Chinese market.

China, Japan, and other destinations in East Asia are also attractive markets for East Siberian and Sakhalin Island gas, but it remains to be seen if Russia develops massive new fields

¹⁸ "Russia: Polar Expedition Means 'Very Little' For Territorial Claims," RFE/RL, August 3, 2007

¹⁹ Ariel Cohen. "From Russian Competition to Natural Resources Access: Recasting U.S. Arctic Policy," Heritage Foundation, Backgrounder #2421, June 15, 2010, at http://www.heritage.org/Research/Reports/2010/06/From-Russian-Competition-to-Natural-Resources-Access-Recasting-US-Arctic-Policy#_ftn62 (March 16, 2011)

²⁰ Shtokman Field, Gazprom Project – Field website, <http://www.gazprom.com/production/projects/deposits/shp/>

²¹ "Statoil Hydro to develop Shtokman field," *New Europe*, Issue 753, October 25 2007, <http://www.neweurope.eu/articles/Statoil-Hydro-to-develop-Shtokman-field-/79155.php>, and "Total signs on Shtokman dotted line," Upstream Online, July 13, 2007, <http://www.upstreamonline.com/incoming/article137232.ece>

²² "New owner of Shtokman license", *Barents Observer*, Energy, February 18, 2009, <http://www.barentsobserver.com/new-owner-of-shtokman-license.4559032-16178.html>

²³ "Shtokman Watchers: Statoil Demonstrates Arctic Capability", *Oil & Gas Eurasia*, July 25, 2007, <http://www.oilandgaseurasia.com/news/p/0/news/835>

in the Arctic, as the difficulties with the recent Rosneft-BP deal may suggest. There, BP's Russian billionaire partners in the TNK-BP joint venture derailed an asset swap and Arctic field development by BP and Rosneft.

Recoverable gas and oil reserves around Sakhalin Island, one of the world's largest natural gas fields, are estimated at almost 7 billion barrels and 80 trillion cubic feet respectively, one of the largest in the world.

The Russian government announced a number of costly programs to explore and develop the East Siberian oil and gas fields and to build a network of oil and gas pipelines in the 2020-2030 timeframe, which will cost tens of billions of dollars.²⁴ In addition, the Russian leadership realizes the need to open up to foreign investment in its energy sector, since Russia needs Western capital and technology to successfully develop its climatically and geologically challenging oil and gas reserves. Furthermore, Russia, unlike any of the other major energy exporting countries, is also one of the world's leading industrial energy consumers, primarily because of the country's inefficient, aging infrastructure and utilities.

Internal Consolidation

The Russian oil and gas sector is notorious for easing domestic and foreign corporations out of majority equity stakes in Russian mega-projects and for consolidating domestic ownership in the hands of government-controlled entities. The two Russian energy national champions—vertically integrated state-owned or controlled global companies capable of competing with foreign corporations—are headed by senior officials close to Vladimir Putin. Putin's former Chief of Staff and later successor as president, Dmitry Medvedev, was the ex-officio chairperson of Gazprom. Today, Putin's one-time mentor, former Prime Minister Victor Zubkov, occupies this position. Putin ally Alexei Miller is the long-serving CEO of Gazprom. Putin confidante and First Deputy Prime Minister Igor Sechin, who is in charge of energy and heavy industry, until recently chaired the board of Rosneft, Russia's largest state-run oil company, which expropriated the bulk of YUKOS assets. This management scheme ensures that Gazprom and Rosneft are reliable foreign policy arms for the Kremlin. Since the early 2000s Moscow limited access by major international energy corporations to giant Russian fields and forced them to give up their majority stakes in lucrative projects.

The Natural Resources Law limited foreign participation in energy exploration projects to minority stakes—25 percent in 'strategic' oil and gas fields, and 49 percent in other energy projects. Limited in their rights to own exploration licenses, the transnational corporations are reduced in many cases to operator or technical service provider roles. In June 2007, then-First Deputy Prime Minister Sergey Ivanov said that foreign companies "will never operate" Russia's major fields again.²⁵

Although leading officials, including Mr. Medvedev, have explicitly rejected state capitalism as a model for Russia, the Kremlin is actively consolidating its ownership in the energy sector. Putin envisages the state not as the great re-nationalizer, but as the biggest shareholder in a privatized economy.²⁶ The return of strategic assets under state control is often

²⁴U.S. Energy Information Administration, Independent Statistics and Analysis, Russia: Country Analysis Brief, November 11, 2010, accessed at: < <http://www.eia.doe.gov/cabs/Sakhalin/Background.html>>.

²⁵ Torrey Clark and Lucian Kim, "Gazprom Gains BP Gas Field as Putin tightens control," *Bloomberg*, June 22, 2007, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=afwFHAGtof3Y&refer=uk>

²⁶ Nick Paton Walsh, "Meet the Chief Exec of Kremlin Inc.," *The Guardian*, July 6, 2005

presented to the public as the restoration of national property illicitly acquired in the mid-1990s by corrupt and politically manipulative oligarchs at deeply discounted prices. This certainly was the case with state-owned Rosneft's 2004 murky acquisition of Yuganskneftegaz, the key production unit of forcibly bankrupted YUKOS. Despite the company's having received a clean bill of health from the Russian tax authorities, the State, through trumped-up bankruptcy proceedings, sold YUKOS to a straw company in a no-bid sale, which in turn sold it to Rosneft at a grossly undervalued price. Rosneft then amalgamated the YUKOS oil-producing company into its operations. The two principal YUKOS principal owners, Mikhail Khodorkovsky, discussed in detail earlier, and his business partner Platon Lebedev, received 13.5 year sentences in two highly flawed court proceedings; and the YUKOS affair became a byword for Russian-style judicial arbitrariness and politically motivated justice.

Western companies were also the subject of heavy-handed state intervention in the energy sector. Royal Dutch Shell was evicted from the Sakhalin project. British Petroleum was evicted from the lucrative Kovykta gas field in eastern Siberia after the forced sale of its 62.9 percent stake to Gazprom in June 2007. The TNK-BP joint venture was unable to meet production quotas prescribed by the Kremlin because pipeline monopolist Gazprom refused to develop any export pipelines. After officials threatened to cancel the license, and the courts refused to intervene, BP-TNK agreed to sell its Kovykta stake to Gazprom at a fraction of its market value.²⁷ Later on, in 2007–2008, the TNK-BP joint venture, with its unique 50–50 control between the Russian and British partners almost fell apart. This was due to pressure from the Russian partners, known as Alfa Access Renova (AAR) to oust the BP-appointed CEO and gain more control of the company. Many experts suspected that the ultimate goal was to force the British company to sell to AAR or to a Russian state-owned oil company; however, falling oil prices and the precipitous Russian stock market slide of 40 percent from May to August 2008 may have put pressure on the Russian partners to settle. A compromise, rare in the Russian oil sector, was achieved in early September 2008, and for now, the joint venture is continuing.

BP, however, signed what its chief executive, Bob Dudley, termed a “milestone” a joint-venture contract with Russia's Rosneft oil giant to develop the oil reserves in Russia's Arctic regions in January 2011.²⁸ However, relations between AAR and BP remain problematic, as the oligarchs sued BP in Great Britain and prevented its agreement with Rosneft from being executed. At this point, BP is trying to buy out AAR from the TNK-BP joint venture. While BP's leadership may envision a new strategy in Russia aimed at overcoming its troubles in the Gulf of Mexico, Russia's past relationship with foreign oil companies and with BP in particular raises many risk management questions.

Due to the resumption of global economic growth, and even before the current instability in the Middle East, oil prices have been increasing since January 2011, and consequently, Russian oil companies been enjoying higher oil revenues.

Sloviki in Charge

The Kremlin-affiliated structures are squeezing independent energy companies to get hold of their assets. In a ground-breaking interview to *Kommersant*, Oleg Shvartsman, then the

²⁷ “Russian Arm Twisting: Another Energy Firm Backs Down,” *The Economist*, June 22, 2007.

²⁸ ABC Staff; *BP signs deal with Russian oil giant*; Australian Broadcasting Corporation, News, Jan 15, 2011, <http://www.abc.net.au/news/stories/2011/01/15/3113634.htm> (Accessed March 1, 2011)

head of the Finansgroup financial-industrial group close to the *siloviki* (“men of force”, primarily the leaders around Putin who have security services backgrounds) revealed a scheme intended to pressure private companies that the Kremlin finds insufficiently accountable to the state.²⁹ Among the group’s key assets is the Russian Oil Group that cooperates with Rosneft, TNK, and Lukoil. After an initial push for trading alliances, Finansgroup began to acquire small and medium-sized oil-refineries, using illicit activities to bring down corporate values prior to the acquisition.³⁰ Finansgroup also manages the so-called Social Investments Corporation, exercising what Shvartsman called the “velvet re-privatization” of strategic assets based on various voluntary and coercive market instruments of asset absorption. Shvartsman said the group enjoys the full support of the Russian “power” ministries, including the Interior Ministry, FSB, and the tax and environmental authorities.³¹

Simultaneously, Russia is seeking to develop its energy services industry. Only recently, the Eurasian Drilling Company, the largest provider of onshore drilling services in Russia, signed a substantive contract with world-famous hydrocarbon oil and gas services firm Schlumberger. According to the strategic contract, a vast exchange of assets will occur between the two industry leaders, but most importantly, Schlumberger will become a subcontractor for Eurasia’s drilling operations for “up to 200 rigs for a 5-year period.”³²

Domestic consolidation of the Russian oil and gas industry under the Kremlin’s direct ownership or control increases Moscow’s options in the continued use of energy as a foreign policy tool. These major takeovers and expropriations further limit opportunities for foreign investment and technology transfer to the Russian energy sector and beyond. They signal the return of statist economic policies, and widespread corruption, while allowing the state to interrupt the flow of oil or gas for political reasons far more easily than a private-sector owned company would be able to do.

Russian Energy Geopolitics to 2020: The American Perspective

Russia’s energy nationalism has been a source of frustration in Washington. From an American perspective, growing European energy imports on monopolistic Russian oil and gas exporters is a negative long-term geopolitical trend. However, there are other issues. Despite being the world’s largest energy consumer, the United States has limited energy relations with Russia. In 2002–2003 Russia refused to construct projects dedicated to oil exports to the United States, such as the Murmansk pipeline, suggested by the then-privately held YUKOS, LUKoil and Sibneft oil companies. Moscow has also derailed attempts by U.S. oil supermajors to buy

²⁹ “*Partiyu dlya nas olitsetvoryaet silovoy blok, kotoryy vozglavlyayet Igor Ivanovich Sechin* [The Party is embodied for us in the power bloc led by Igor I. Sechin].” *Kommersant*, November 30, 2007, <http://www.kommersant.ru/daily.aspx?date=20071130>.

³⁰ Jonas Bernstein, “Finansgroup: How Russia’s Siloviki Do Business,” Jamestown Foundation *Eurasia Daily Monitor*, November 30, 2007, www.jamestown.org.

³¹ “*Partiyu dlya nas olitsetvoryaet silovoy blok, kotoryy vozglavlyayet Igor Ivanovich Sechin* [The Party is embodied for us in the power bloc led by Igor I. Sechin].” *Kommersant*, November 30, 2007, <http://www.kommersant.ru/daily.aspx?date=20071130>.

³² *Eurasia Drilling Company and Schlumberger Enter Strategic Alliance, Sell and Purchase Assets*, Schlumberger, Press Release, October 5, 2010, http://www.slb.com/news/press_releases/2010/2010_1005_edc_slb_alliance.aspx (Accessed on March 1, 2011)

significant non-controlling stakes in large private Russian companies such as YUKOS. On the other hand, Gazprom considered and abandoned plans to export LNG to the US West Coast.

If Moscow is serious about the “reset”, it needs to address a number of fundamental issues, first and foremost the issues of market access and the rule of law. First, US companies should gain access to oil and gas fields and pipeline projects, not limited by the obsolescent Natural Resources Law and the state-owned pipeline monopolies.

Second, for Russia to develop its Arctic and East Siberian reserves, it needs to put an end to corruption; completely revamp the rule of law, including assuring independence of the courts from the executive branch regardless of the scope of disputes and the powerful personas involved. The Russian government should provide Western companies enforceable guarantees that foreign investment will not be jeopardized by moving goalposts; revising the terms and conditions of prior investments. Ideally, it should also significantly disinvest the state from the natural resources sector. Finally, prior violations of the rule of law need to be redressed.

Energy issues spill over into the realm of the geopolitical balance-of-power. When energy prices skyrocketed in 2007-2008, Russia quickly evolved into an assertive anti-status quo power that challenged the U.S. and its allies on many fronts, especially in the territory of the former Soviet Union, as the 2008 Russian-Georgian Five Day War demonstrated. There are also ongoing frictions in the Balkans and the Middle East, where Russia has opposed Western policies. This happens both because of the ample funding available to finance a more ambitious foreign policy due to energy revenues and the self-assurance which comes with general economic prosperity, as well as from Moscow’s tendency to use energy as a foreign policy tool. As oil prices rise, it is safe to expect Russia’s cockiness to return.

Russia’s strategic goals include preventing countries around its borders from becoming pro-American as well as increasing control over the transportation of Russia hydrocarbons through the territory of its neighbors. Furthermore, the Kremlin aims to control the export of oil and gas from neighboring countries by directing their flow via the Russian pipeline system. By locating pipelines and gas storage facilities in Austria, Hungary, Bulgaria, Greece and Turkey, Russia connects them to Moscow with ties that bind. Sometimes, these ties also include lucrative personal economic deals, as demonstrated by the employment of Gerhard Schröder as Chairman of the North Stream gas pipeline consortium, and similar arrangements for other prominent European politicians.

Russia also attempted to push the United States out of Central Asia, and successfully limited US participation in new Caspian energy projects, excluding it from the SCO’s Energy Club. The United States, for its part, supports diversification of energy transportation routes in Eurasia. From the Russian perspective, the U.S. and EU-backed pursuit of diversified energy sources and transportation routes is unfriendly towards Russia, politically motivated, economically unfeasible and environmentally damaging. The Kremlin is likely to use Europe’s dependence on Eurasian energy to exacerbate differences in transatlantic relations and use its influence to minimize the pro-American foreign policy agenda. In the current decade, America’s allies in Europe may face tough choices between the cost and stability of their energy supply, on one hand, and siding with the United States on key issues, on the other hand.

In sum, the developed world economies and energy net importers in general will benefit from greater stability, security, transparency, and the rule of law in energy-exporting states, to ensure that oil and gas remain readily available, ample, affordable, and safe. However, the Kremlin views energy as a tool of assertive foreign policy and uses it broadly, often without much concern for diplomatic niceties. If current trends prevail, this decade may see the Kremlin

might translating energy monopoly into increasing foreign and security policy influence in Europe. In particular, Russia is seeking recognition of its predominant role in the post-Soviet space and Eastern Europe. This has already affected geopolitical issues important to the West, such as NATO expansion, ballistic missile defense, the tension around the status of Kosovo, and Moscow's increasing influence in the post-Soviet space.

Furthermore, before the current instability erupted, Moscow was seeking to re-engage in a centuries-old balance-of-power game in the Middle East, from Algeria, where it attempted a gas condominium, to Syria, where it is rebuilding naval bases in Tartus and Ladakiye and supplying modern weapons, to Iran and India.³³ Though in the end it voted in the UN Security Council with the U.S. and Europe during diplomatic crises over the Iranian nuclear enrichment program, Moscow has continually provided Teheran ample diplomatic cover in the United Nations and elsewhere, as well as expanded arms supplies. Moscow also abstained in the UNSC vote on Libya – together with China and Germany. Premier Putin harshly criticized the Libya war as a “new crusade”, clearly trying to score points for Russia in the Middle East. The Obama Administration seems to be less concerned about European energy dependence on Russia than its predecessor was. Just recently, Russian President Dmitry Medvedev and the American president announced plans to liberalize visa restrictions for businessmen and tourists travelling between the two countries in a joint statement at the [G8 summit in Deauville](#). “We have instructed our officials to concentrate on visa liberalization on a reciprocal basis for the largest segments of our traveling nationals,” the statement said. Under the new agreement, eligible business travelers and tourists would be issued visas valid for 36 months at a unified and reciprocal fee. Government officials would also be eligible to receive 12-month multi-entry visas.³⁴ While freedom of travel is a good thing overall, the US Congress is seeking to limit travel to the US on the part of clearly corrupt Russian officials or those engaged in human rights violations or property expropriation, as will be discussed *infra*. In this respect, the Administration is defying Congress and going in a wrong direction.

There are a number of steps the Obama Administration and Congress can take to address Russian state graft and corruption. Some of these measures were outlined by The Heritage Foundation.³⁵ Specifically, the Administration should increase cooperation among U.S. and allied intelligence services, law enforcement agencies, and independent experts to track Russian state and oligarch money laundering activities, corruption, and unfair competition practices. The White House should encourage U.S. and other multinational companies to compete in economically viable energy and infrastructure projects overseas through free-trade, diplomatic and security support, and regulatory and tax policies that will enhance free competition without government-directed investment decisions. U.S. companies should be encouraged to compete for

³³ “Top Russian arms clients: India, Algeria, China, Venezuela, Syria”, *World Tribune*, News, January 29, 2010, http://www.worldtribune.com/worldtribune/WTARC/2010/eu_russia0069_01_29.asp

³⁴ “[Medvedev, Obama vow to liberalize bilateral visas](#)”, <http://en.rian.ru/russia/20110526/164249981.html>

³⁵ Ariel Cohen, Ph.D. and Lajos Szaszdi, Ph.D. “Russia's Drive for Global Economic Power: A Challenge for the Obama Administration”, Backgrounder #2235, *January 30, 2009* <http://www.heritage.org/Research/Reports/2009/01/Russias-Drive-for-Global-Economic-Power-A-Challenge-for-the-Obama-Administration>

participation in the development of Turkmenistan's gas fields as well as in other geopolitically significant ventures, which Russia is targeting in India, Southeast Asia, Africa, and Latin America. The US should promote market-viable alternative energy sources and unconventional sources of fuels worldwide to counter the West's strategic dependency on Russian, Iranian, and Venezuelan oil. This should be accomplished through deregulation and trade and tax policies that encourage innovation and investment to develop, and through commercializing new sources of energy that best meet the needs of individual regions and nations. Western economies will be better off by expanding the supply of transportation fuels and reducing their Russian energy imports, thus reducing the influx of revenue into Kremlin coffers. Last but not least, the US should expand security cooperation with Russia's energy-exporting neighbors and other countries that Russia is targeting for energy cooperation, including train-and-equip programs for military and security forces protecting pipelines, and officer corps education in U.S. military colleges, and should make better use of NATO's Partnership for Peace program.

Washington should encourage Europe's energy diversification, providing political and diplomatic support to major consumers of Russian oil and gas to develop alternative energy pipelines throughout Europe and Eurasia. It is vital for EU members to come up with a joint position on energy geopolitics instead of lucrative bilateral deals, which only increase the region's dependence on Russian oil and gas. It is also necessary to insist that Russia live up to its commitments to uphold and implement the rule of law, without which its economic development, property rights, and civil liberties will remain in limbo. Otherwise, Russia will be positioned to apply the ancient Roman principle—*divide et impera*—to 21st century energy geopolitics. Finally, Congress should pass – and the president should sign – S. 1039, the Sergei Magnitsky Rule of Law Accountability Act of 2011. This bill, dedicated to the memory of a Moscow whistleblower lawyer who died in jail under torture in November of 2009, revokes visas and prohibits financial transactions for Russian officials who engage in

extrajudicial killings, torture, or other gross violations of human rights committed against individuals seeking ... to expose illegal activity carried out by officials of the Government of the Russian Federation; or ... to obtain, exercise, defend, or promote internationally recognized human rights and freedoms, such as the freedoms of religion, expression, association, and assembly and the rights to a fair trial and democratic elections (Section 4, Paragraph 2).

Congress has an important role to play in changing the relations with Russia in the energy field for the better, for the benefit of the Russian and American peoples and our European allies. It is time to make the Russian oil and gas sector more transparent and open to foreign investment while curbing the use of energy as a geopolitical tool, which endangers Russia's neighbors.

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United States House of Representatives
Committee on Foreign Affairs

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